MARKET REVIEW

Irish Life

OCTOBER 2015

Markets recovered in October with a strong rebound in equity markets while bonds experienced more modest gains. While economic data in developed markets was less resilient than had been the case through September, there was some stabilisation in economic releases across Asia in general while there was also greater comfort in relation to Chinese data with fears over a potential hard landing in the Chinese economy easing somewhat. Suggestions of additional monetary stimulus from the ECB, more confident commentary from the US Fed and the announcement of further interest rate reductions in China also supported markets in October.

Equities began to recover early in the month, driven initially by short covering by investors who had previously reduced exposures as chart and technical resistance levels in markets were broken to the upside. Gains were added to as the ECB was more dovish than expected at its policy meeting when highlighting that the degree of monetary accommodation needs to be re-examined at the December meeting. A few council members were said to have already wanted to expand the level of monetary accommodation at the October meeting. The ECB indicated all policy options will be considered, including possible further reductions in the deposit rate which is already at a negative rate of -0.2%. Shortly after the ECB comments, China reduced interest rates for the sixth time since last November by 0.25% and cut bank reserve requirements by 0.5% which also supported markets. In contrast, the US Fed was more hawkish than expected, suggesting that the first US interest rate rise of the current cycle could occur in December. However its more confident tone in relation to the economic backdrop in the domestic US economy and the omission of previous expressions of concerns over the potential negative impact of global economic and financial developments on the US economy contributed to increased confidence among investors with regard to the future outlook of the US economy. In Japan, in response to the recent improvement in economic data and expectations of an eventual pick-up in inflation due to rising corporate and consumer activity, the Bank of Japan did not add to the current level of monetary policy accommodation at its end of October meeting. There were suggestions in the press however that the government is planning to implement an additional Y3trn fiscal stimulus package.

Corporate earnings reporting seasons were mixed with US earnings exceeding previously downgraded forecasts by approx. 5% to date. European results to date however have been approx. 10% below expectations.

On the macro front, in the US, non-farm payrolls, retail sales, durable goods orders and elements of housing data disappointed and were softer than evident in recent months while Q3 GDP was slightly below expectations at 1.5% annualised and was significantly below the 3.9% growth seen in Q2. In Europe, German trade, factory orders and industrial production disappointed although in general across the Eurozone, sentiment surveys remained solid and consistent with growth of around 2%. UK Q3 GDP slowed to 0.5% q/q or 2.3% y/y due to softer manufacturing and construction activity. In Japan, economic releases improved through the second half of the month with better than expected PMI releases and industrial production. Trade and manufacturing releases in key Asian markets such as Taiwan and Korea also rebounded during the month. While Chinese data was somewhat mixed, it suggested that economic growth remained solid and that the economy was not about to experience a hard landing.

Over the month the FTSE All World equity index rose 7.6% (9.0% in ¬). Japanese equities rose 10.9% (11.2% in ¬) as economic data improved, the government announced plans to cut corporate taxes and additional fiscal stimulus was expected. The US rose 8.2% (9.3% in ¬) as fears over possible contagion from weaker Chinese growth eased and a compromise in relation to the debt ceiling and budget issues was reached. European equities rose 8.1% (8.2% in ¬) on expectations of additional ECB stimulus. The UK lagged, rising 5.1% (8.2% in ¬) on a slower growth backdrop while emerging markets also lagged, rising 5.4% (8.3% in ¬) as expectations for the first US interest rate rise were pulled forward. Eurozone > 5 year bonds rose 1.5% as the ECB suggested an expansion of QE was possible with German 10 year bond yields falling to 0.52% while peripheral spreads generally narrowed over the month as a whole post the ECB comments regarding the possibility of additional asset purchases. Spanish spreads however rose slightly into month end to 118bps as the Catalonian parliament announced plans to declare independence for the region. Portuguese 10 year yields rose over the month due to uncertainty surrounding the stability of the newly formed minority government. Commodities rose 1.1% with Brent oil up 2.5% on lower US production and inventories. The Euro weakened to 1.105 against the US dollar as the ECB indicated additional stimulus was possible while the Fed suggested the first US interest rate rise could occur in December.

Markets In October	Local Returns	Euro Return
Ireland	4.8	4.8
UK	5.1	8.2
US	8.2	9.3
North America	7.9	9.1
Europe	8.1	8.2
Japan	10.9	11.2
Pacific	5.6	8.7
Emerging Markets	5.4	8.3
World	7.6	9.0
EMU Govt Bonds >5yr	1.5	1.5
Commodities	1.1	2.2

Markets YTD	Local Returns	Euro Return
Ireland	26.4	26.4
UK	0.4	9.0
US	2.5	12.2
North America	2.1	11.0
Europe	11.0	13.2
Japan	12.4	22.4
Pacific	-1.5	0.5
Emerging Markets	-1.8	-0.5
World	3.6	10.5
EMU Govt Bonds >5yr	3.1	3.1
Commodities	-13.1	-4.8

US Economics and Rates

US economic data was mixed but overall was slightly disappointing. Q3 GDP grew 1.5% annualised, slightly below expectations of 1.6%. Consumer spending rose 3.2% and business fixed investment rose 2.9%. Net trade was neutral in Q3 in terms of its contribution to growth while inventory reductions reduced growth by 1.4%. Elsewhere, ISM manufacturing fell -0.9 to 50.2, services fell -2.1 to 56.9 while the composite PMI fell -0.5 to 55.0. Small business confidence rose 0.2 to 96.1. Industrial production fell -0.2% m/m while factory orders fell -2.0% m/m. Non-farm payrolls were below expectations, rising only 142,000 in September, while previous month's figures were revised down. The unemployment rate was unchanged at 5.1%. Average hourly earnings rose 2.2% y/y from 2.1% previously. The quarterly employment cost index rose 0.6% q/q and 2.0% y/y. Headline retail sales disappointed, rising only 0.1% m/m while consumer confidence fell -5.4 to 97.6. Personal income and personal consumption both rose 0.1% m/m, slightly below expectations. Headline durable goods orders fell -1.2% m/m while orders ex transport fell -0.4% m/m and capital goods orders fell -0.3% m/m although shipments rose 0.5% m/m. Housing data was more mixed than recent months. House prices in the top 20 cities rose 0.1% m/m and were up 5.1% y/y. Housing starts rose 6.5% m/m although building permits fell -5.0% m/m. New home sales fell -11.5% m/m although existing home sales rose 4.7% m/m. House builder sentiment rose 2 to 64, a new high for the current recovery. CPI fell -0.2% m/m and was flat y/y. Core CPI ex food and energy rose 0.2% m/m and 1.9% y/y.

The Fed left policy unchanged at the October meeting. The post meeting statement however surprised investors with the Fed signalling that it is giving serious consideration to an interest rate rise in December. Previously the Fed had indicated that up to now it is has been assessing economic data to determine how long it should maintain interest rates at their current level. The October statement however outlined a clear shift in the Fed's thinking when it said it will be assessing upcoming data to determine whether it will be appropriate to raise interest rates at its next meeting in December. References to concerns over global economic and financial developments and the potential threat they pose to the US economy were omitted, suggesting the Fed was less concerned about possible negative contagion from emerging markets. The description of the growth in household and business spending was revised up to 'solid' and while the description of job growth was downgraded to 'steady', the underutilisation of labour resources was again described as having diminished since earlier in the year. Overall, the generally more positive tone of the statement and specific reference to a possible rate rise in December contributed to a pulling forward of expectations for the timing of the first US rate rise from Q1 2016 with a 50/50 probability being assigned to a December rate rise by investors following the Fed statement.

European Economics and Rates

European data was mixed with hard data disappointing somewhat while many sentiment surveys surprised positively. The Eurozone composite PMI rose 0.4 to 54.0 with services up 0.5 to 54.2 and manufacturing flat at 52.0. ZEW expectations fell -2.3 to 30.1 and Sentix business sentiment fell -1.9 to 11.7. Economic confidence rose 0.3 to 105.9, a new post-recession high, industrial confidence rose 0.3 to -2.0, services confidence fell -0.5 to 11.9 and the overall business climate indicator rose 0.10 to 0.44. Industrial production fell -0.5% m/m but was up 0.9% y/y while construction output fell -0.2% m/m and -6.0% y/y. Retail sales were flat m/m but rose 2.3% y/y while consumer confidence fell -0.6 to -7.1. Unemployment fell 0.2% to 10.8%. Money supply growth improved slightly with M3 growing 4.9% y/y from 4.8% previously. Headline inflation was flat y/y while core inflation rose 0.1% to 1.0% y/y.

The German composite PMI rose 0.4 to 54.5. The IFO business climate slipped -0.3 to 108.2 although the expectations component rose 0.5 to 103.8. ZEW expectations fell -10.2 to 1.9 while the ZEW current situation index fell -12.3 to 55.2. Retail sales were flat m/m but were up 3.4% y/y while consumer confidence slipped -0.2 to 9.4. Industrial production fell -1.2% m/m but was up 2.3% y/y while factory orders fell -1.8% m/m. The French composite PMI rose 0.4 to 52.3. Business confidence rose 1 to 101 while consumer confidence fell -1 to 96. Consumer spending was flat m/m but rose 2.6% y/y. Industrial production rose 1.6% both m/m and y/y. In Spain, Q3 GDP grew 0.8% q/q and 3.4% y/y. The composite PMI fell -4.2 to 54.6, industrial output rose 2.7% y/y and retail sales rose 4.3% y/y. Unemployment fell 1.2% to 21.2%. The Italian composite PMI fell -1.6 to 53.4 while industrial production fell -0.5% m/m. Retail sales rose 0.3% m/m m/m while consumer confidence rose 3.9 to 116.9 and business confidence rose 1.5 to 104.2. Unemployment fell 0.1% to 11.8%.

The ECB left policy unchanged at the October meeting, however the statement and in particular commentary at the post meeting press conference was much more dovish than expected. The statement referred to external developments continuing to signal downside risks to growth and inflation. As a result it was believed that the factors which are causing inflation to remain below the ECB's 2% target require further thorough analysis. In this context it was indicated the degree of monetary accommodation currently being conducted needed to be re-examined at the December policy meeting. Updated Eurosystem staff economic forecasts which will be available at that point will be used in determining *any decision in relation to further stimulus. During the press conference President Draghi indicated a few council members had wanted to already increase the level of monetary accommodation at the October meeting. He also described the ECB's stance as having moved from a 'wait and see' mode to a 'work and assess' mode, suggesting policy changes are likely at the next meeting in December. It was indicated that the ECB is willing and able to use all instruments within its mandate and it has sufficient flexibility within the current asset purchase programme to adjust the size, composition and duration of the purchases being undertaken. President Draghi made it clear that a further reduction in the deposit rate from the current negative rate of -0.2% was among the policy options which will be considered. Overall, post the meeting and press conference, investors expected additional monetary stimulus measures to be announced by the ECB at the next meeting in December.*

UK Economics and Rates

UK data was mixed with some signs of slower growth although growth remains relatively strong at just over 2%. Q3 GDP was slightly below expectations at 0.5% q/q and 2.3% y/y compared to 0.7% q/q and 2.4% y/y in Q2. The services sector grew 0.7% q/q from 0.6% q/q in Q2. Construction output contracted -2.2% q/q. Manufacturing fell -0.3% q/q but resource extraction grew 2.4% q/q resulting in overall industrial production rising 0.3% q/q. Elsewhere, the composite PMI fell -1.8 to 53.3 with services down -2.3 to 53.3, manufacturing was flat at 51.5 while construction rose 2.6 to 59.9. Headline retail sales rose 1.9% m/m and 6.5% y/y, boosted by promotions around the rugby world cup although consumer confidence fell -1 to 2. Unemployment fell 0.1% to 5.4% with numbers employed up 140,000 over three months from 42,000 previously. Average weekly earnings ex bonuses rose 2.8% y/y from 2.9% previously. Industrial production rose 1.0% m/m and 1.9% y/y while construction output fell -4.3% m/m and -1.3% y/y. CPI fell -0.1% both m/m and y/y. The Halifax house price index fell -0.9% m/m but was up 8.6% annualised over 3 months compared to 9.0% previously while mortgage approvals fell 2,100 to 68,900 per month.

The Bank of England (BoE) left policy unchanged in an 8:1 vote. The committee saw few signs that the emerging economy slowdown was having a material impact on the economy and confidence levels although some believed it had weakened the growth outlook. It was noted that there had been mixed signals from the data since the previous month with wage growth still rising while at the same time there was some evidence of cost pressures being reduced through improving productivity levels. There was a recognition that domestic growth was slowing somewhat but it was noted there was also evidence of skill shortages in some sectors. Generally, the environment of slowing growth and stabilising employment was viewed as being consistent with an economy returning towards its full potential. Overall, the tone of the statement was marginally more dovish than previously with references to the potential for lower inflation in the near term, slowing growth and potential risks from international developments. However it was again emphasised that low inflation was seen as a temporary development mainly due to lower oil prices and inflation is still expected to return to the 2% target level over the medium term. Also, despite the risks posed by international developments, in general it was believed they were not having a material impact on the UK economy. The minutes made a number of references to a reassessment of the outlook post the updating of economic forecasts at the November meeting. With the subsequent pulling forward of expectations for the first US rate rise following the late October Fed policy meeting, by month end expectations for the first UK rate rise had also been pulled forward to Q3 2016.

Asian Economics and Rates

Japanese data continued to disappoint early in the month but key readings such as industrial production and manufacturing PMI improved towards month end. Industrial production rose 1.0% m/m but was down -0.9% y/y while machine orders fell -5.7% m/m. Retail sales fell -0.2% m/m but rose 0.7% y/y while consumer confidence fell -1.1 to 40.6. Exports rose 0.6% y/y while imports fell -11.1% y/y. The composite PMI fell -1.7 to 51.2 although the manufacturing PMI rose 1.5 to 52.5. The Economy Watchers current reading fell -1.8 to 47.5 while the outlook reading rose 0.9 to 49.1. Small business confidence fell -0.3 to 48.7. The Tankan large manufacturers' business sentiment index fell -3 to 12 while the large services index slipped -2 to 23. Bank lending growth slowed to 2.6% y/y from 2.8% y/y. The tertiary index rose 0.1% m/m. Headline CPI was flat y/y while core CPI ex fresh food and energy was up 1.2% y/y.

The Bank of Japan (BoJ) again left policy unchanged in an 8:1 vote, despite lowering its growth and inflation forecasts and pushing out the expected timing for the achievement of its 2% inflation target. The decision to leave the level of monetary stimulus unchanged was based on the belief that low inflation will prove to be transitory and that inflation will ultimately increase. The economy was described as recovering moderately although exports and production were said to be affected by the slowdown in emerging economies. Inflation forecasts for CPI ex fresh food were reduced to 0.1% for fiscal year 2015, 1.4% for 2016 and unchanged at 1.8% for 2017. The 2% inflation target is now expected to be achieved between September 2016 and March 2017, six months later than previously suggested. GDP forecasts were similarly reduced to 1.2% for 2015 and 1.4% for 2016 although 2017 was increased to 0.3%. The potential for an increase in monetary stimulus in coming months appears to have reduced with the BoJ expressing confidence that domestic demand will remain firm based on record high corporate profits and a tight labour market. The rise in the BoJ's new definition of core inflation (CPI ex fresh food and energy) to 1.2% y/y was highlighted as being indicative of a rising underlying inflation trend while a narrowing output gap and resilient inflation expectations were also viewed as reducing the requirement for additional monetary loosening. It was however indicated that the BoJ will be closely watching the April wage negotiations for evidence of wage inflation and thus further upward pressure on general pricing. At this stage, additional fiscal rather than monetary stimulus appears to be the more likely policy option to be adopted in Japan.

Chinese data again was mixed but began to show some signs of stabilisation after the recent deterioration in economic news flow. Q3 GDP rose 1.8% q/q compared to 1.7% in Q2 and was up 6.9% y/y. The Caixin manufacturing PMI was flat at 47.2, services fell -1.0 to 50.5 while the composite index fell -0.8 to 48.0. Official manufacturing PMI rose 0.1 to 49.8 while services was flat at 53.4. Exports fell -3.7% y/y from -5.5% previously while imports fell -20.4% y/y from -13.8% previously. Retail sales growth improved to 10.9% y/y from 10.8% previously, industrial production growth slipped to 6.2% y/y from 6.3% while fixed asset investment growth fell to 10.3% y/y from 10.9%. Industrial profits fell -0.1% y/y from -8.8% y/y previously. Monthly new lending figures rose Rmb 240.4bn to Rmb 1050.0bn.

The Peoples Bank of China reduced interest rates for the sixth time since last November, reducing lending and deposit rates by 0.25% to 4.35% and 1.5% respectively. Bank reserve requirements were also reduced by 0.5% for all lenders, falling to 17.5% for the largest lenders.

Irish Economics

Economic releases generally remained positive. Numbers on the Live Register on a seasonally adjusted basis fell 4,100 to 337,300. Retail sales rose 0.3% m/m and 8.6% y/y. Core retail sales ex autos rose 0.7% m/m and 8.0% y/y. Consumer confidence fell -0.5 to 100.6. Industrial production remains volatile, falling -1.0% m/m but was up 14.3% y/y. The monthly seasonally adjusted trade surplus rose ¬194m to ¬3,725m. Exports were down -1.4% m/m while imports fell -6.0% m/m. Given the better trade data year to date, the trade surplus for the year should rise for the first time since 2010. Irish residential property prices rose 1.3% m/m and were up 8.9% y/y. Dublin prices rose 0.9% m/m and 6.5% y/y. Prices outside Dublin were up 1.6% m/m and rose 11.4% y/y. CPI fell -0.5% m/m and -0.3% y/y. The manufacturing PMI rose 0.2 to 53.8 while services rose 0.3 to 62.4.

Exchequer returns to the end of September remained positive and showed the government balance being ¬2.4bn or 1.5% of GDP ahead of target at that point. Prior to the announcement of the budget however, the government indicated it plans to increase the level of spending in 2015 by ¬1.5bn above its previous target, thus resulting in a predicted fiscal deficit for 2015 of 2.1% of GDP. This is ahead of the official 2.3% target announced earlier this year but higher than implied by the exchequer returns at the end of September. The October budget announcement included ¬1.5bn of expansionary measures, split 50/50 between tax reductions and increased expenditure. The government forecast a fiscal deficit of 1.2% of GDP in 2016 taking account of the measures announced in the budget.

Bonds

The Merrill Lynch Eurozone Government Bond Index > 5 years posted a gain of 1.52% in October, bringing the return for year to date to +3.11% Bond markets rallied through the month as market expectations grew about further monetary easing by the ECB.

Mario Draghi indicated at the ECB press conference that all available tools would be up for consideration at the December ECB meeting. He particularly mentioned the deposit rate which could be cut further into negative territory. The market is now pricing a 10bps cut to bring the deposit rate to -0.30%. Additional purchases under the bank's QE programme and an extension in the programme may now also be on the table. This provided additional support to risk assets and was aided by improved data out of China. The Federal Reserve Chairperson, Janet Yellen, indicated that the Fed may look to raise rates in December this year and that the concerns over emerging markets had dissipated somewhat. Expectations had drifted out to later in 2016 for the first US rate rise in almost a decade.

The general election results in Portugal have led to an unstable minority government of the ruling PSD-CSD coalition. President Cavaco Silva warned against any political steps that would jeopardize Portugal's euro area membership. Portuguese bond spreads have underperformed other peripheral countries and are now 100bps wider than Italy in 10 year. Early elections could be held, but only after September 2016, as constitutional constraints are likely to prevent an earlier move.

Emerging Markets

Emerging Market (EM) equities lagged, rising 5.4% (8.3% in ¬). The pulling forward of expectations for the timing of the first US post the Fed meeting was a relative negative development for EM equities. The possibility of higher rates in the US is seen as potentially giving rise to a reversal of flows from emerging markets to US markets. Asian markets rose 6.1% with China up 9.1% as fears of a hard landing in the Chinese economy began to ease with some stabilisation in economic data. A pick up in industrial production and exports across the Asian region also contributed to the better performance in Asian markets in general. European markets rose 4.0% while Latin American markets gained 3.1%.

Corporate Bonds

Eurozone corporate bonds rose 1.44%, benefiting from the better sovereign bond backdrop. Spreads against sovereign bonds also narrowed as global growth concerns began to ease and fears over a possible rise in corporate default rates reduced. Sectors which outperformed included insurance, autos and consumer cyclicals while those which underperformed included construction machinery, transportation and finance companies.

Commodities

Commodities rose 1.1% (2.2% in ¬). Energy fell -0.3%. Brent oil rose 2.5% on lower US production and inventories. Natural gas however fell -15.3%. Industrial metal prices were down -2.8% led by aluminium which fell -7.0% and nickel which was down -3.4%. Precious metals rose 2.9% with gold up 2.4%. Agricultural prices rose 1.5% led by sugar which was up 12.7% and cotton which rose 4.8%. Livestock prices rose 3.0% as feeder cattle prices rose 9.3% while lean hog prices fell -11.3%.

Source: ILIM 3rd November